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REPORT FROM THE COMMISSION

Annual Report of the Instrument for Structural Policy for Pre-Accession (ISPA) 2005

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This report is presented in accordance with Article 12 of the ISPA Regulation. It is the 6th Annual Report covering the ISPA activities during 2005.

The information outlined in this report is presented in a greater detail in the Commission staff working paper (annex to this report).

1. INTRODUCTION

As a result of the European Council of June 2004 which accepted Croatia as a candidate country, the report now includes, in addition to Bulgaria and Romania, Croatia which is entitled to ISPA assistance since 1 January 2005.

2. ISPA BUDGET

In the Commission budget for 2005, €525.7 million was allocated to the ISPA instrument. The appropriations covered all expenses for co-financing projects (measures) in the beneficiary countries in the environment and transport domains, as well as for providing technical assistance (*TA*), irrespective whether the TA measures were initiated by the beneficiary countries or by the Commission.

Table 1: ISPA budget in 2005 – in Euro

Budget line	Commitment appropriations	Commitments implemented	Payments implemented
Functional budget line B13.01.04.02	3 763 290	3 251 762	1 414 187
Operational budget line B13.05.01.01	521 950 000	521 950 000	231 243 551
Total	525 713 290	525 201 762	232 656 738

3. PROJECT FUNDING

3.1. New ISPA projects

In 2005, the Commission approved 24 new ISPA measures concerning 11 investments in the environment field and 4 in the transport sector, as well as 8 TA projects -7 in the transport sector and 1 in the environment sector-, and one horizontal TA measure. The total ISPA contribution in that year amounted to €493 million, representing an average grant rate of 70% of a total eligible project cost of €705 million. Commitments totalling €521.9 million were used for new projects (€312 million) as well as for ongoing projects adopted in the previous years.

In the environment sector, ISPA assisted predominantly sewage collection and treatment projects, but also two solid waste projects. In the transport sector, the most important project was a combined road/rail project.

Table 2: New projects approved in 2005 – in Euro

Sector	Projects n°	Eligible cost	ISPA contribution	Grant rate %	Commitments in 2005
Environment	12	424.710.000	299.112.500	70.4	195.489.417
Transport	11	279.886.500	193.850.755	69.3	116.681.100
Horizontal TA	1	20.000	20.000	100.0	10.000
Total	24	704.616.500	492.983.255	69.9	312.180.517

3.2. Projects funded during 2000-2005

Between 2000 and 2005, the Commission grant-assisted 96 projects on the basis of proposals submitted by Bulgaria, Croatia and Romania: 65 in the environment sector, 28 in the transport sector, and three horizontal TA measures (two for achieving decentralised implementation (*EDIS*) and one for organising monitoring committees). These projects represent a total project cost of €4.7 billion, of which €4.3 billion are eligible for ISPA funding. ISPA funds contributed 67%, or €2.9 billion to these eligible investment costs. A strict balance between both sectors was maintained.

End 2005, more than 97% of the funds set aside for the three beneficiary countries for the period 2000–2006 had been allocated and, from these allocations, almost 83% had been committed.

Table 3: Projects approved in 2000-2005 – in Euro

Sector	Project decisions n°	Eligible cost	ISPA contribution	Average grant rate %	Commitments
Environment	65	2.021.031.383	1.455.900.551	72.0	1.210.854.471
Transport	28	2.306.715.498	1.457.115.989	63.2	1.189.043.388
Horizontal TA	3	1.633.308	1.633.308	100.0	1.492.308
Total	96	4.329.380.189	2.914.649.848	67.3	2.401.390.167

3.3. Payments

Overall ISPA payments in 2005 totalled €229 million, which represented an increase of no less than 73.5% in comparison with the payments made in 2004 (€132.2 million). By the end of the period 2000-2005, nearly €559 million had been paid out, representing 23.3% of the budgetary commitments implemented in that period.

Table 4: Payments – in Euro

Sector	2000-2004	2005	Total
Environment	145.549.014	109.694.489	255.243.503
Transport	183.364.692	119.346.710	302.711.402
TA	924.524	58.800	983.324
Total	329.838.230	229.100.000	558.938.230

4. TECHNICAL ASSISTANCE

4.1. Technical assistance on the initiative of the beneficiary country

TA measures for *project preparation* have to ensure that beneficiary countries present a sufficient number of quality projects in time for funding, incl. for future funding from the Cohesion Fund and IPA. Similarly, TA measures for *institutional strengthening* aim at enhancing the capacity of the beneficiary's administration to manage and monitor the implementation of large-scale infrastructure investments.

In 2005, 7 applications concerning project preparation and/or institutional building in the transport sector and one application concerning project preparation in the environment sector were approved.

Table 5: New TA - projects approved in 2005 – in Euro

Sector	N° Projects	Eligible cost	ISPA contribution	Grant rate %	Commitments
Environment	1	25.000.000	12.500 000	50.0	8.750.000
Transport	7	74.675.500	62.199.075	83.3	46.141.710
Horizontal TA	1	20.000	20.000	100.0	10.000
Total	9	99.695.500	74.719.075	100.0	54.901.710

When considering the period 2000-2005, ISPA awarded over €119 million to more than 20 projects concerning institutional building or the preparation of projects.

**Table 6: Technical assistance on the initiative of the beneficiary country
2000-2005 - in Euro**

Sector	N° of projects	Eligible cost	ISPA contribution
Environment	7	67.481.000	47.448.500
Transport	11	84.461.560	70.126.620
Horizontal TA	3	1.633.308	1.633.308
Total	21	153.575.868	119.208.428

4.2. Technical assistance on the initiative of the Commission

The Commission carries out these TA activities either through *ad hoc* actions launched in previous years, or in the framework of *TA Action Programmes*:

- *Technical assistance activities undertaken outside the TA Action Programmes* comprise services contracts for providing technical and financial expertise to DG Regional Policy to assist in project appraisal and policy development. Assistance for *intra muros* deconcentration activities with the EC Delegations was closed in 2004.

- *Technical assistance activities financed under the “TA Action Programme 2001”* comprise the organisation of the statutory ISPA monitoring committees, the strategic analysis of the Via Baltica, the promotion of higher quality of ISPA funded public utilities in the water and waste sector, and advise on public-private partnerships.

- *Technical assistance activities financed under the “TA Action Programme 2004-2006”* are a follow-up of the TA Action Programme 2001, albeit focusing only Bulgaria and Romania, and incorporates new framework contracts for the appraisal of ISPA project proposals previously financed outside the Action Programmes. In addition to these contracts, the activities include *extra muros* support to EC Delegations' supervisory tasks, improvement of the quality of environment and transport projects throughout the project cycle, and project appraisal and quality control by the EIB.

- *Technical assistance activities financed under the “TA Action Programme 2005-2006 for Croatia”* provide resources for the EC Delegation in Zagreb to perform supervisory tasks (*intra* and *extra muros*) related to ISPA implementation within the framework of deconcentrated management.

Table 7: Technical assistance on the initiative of the Commission 2000-2005 – in Euro

Activity	Indicative allocations	Commitments	Payments
Activities outside the Action Programmes	4.210.000	4.210.000	2.885.726
Action Programme 2001(*)	12.000.000	11.860 864	7.594.070
Action Programme 2004-2006	10.067.680	6.419.950	3.650.397
Action Programme 2005-2006 for Croatia	1.200.000	400.000	-
Total	27.477.680	22.890.814	14.130.193

(*) Including some activities relating to ISPA beneficiary countries which became Member state in 2004

5. MANAGEMENT AND IMPLEMENTATION

5.1. Project monitoring

While the first ISPA projects were approved by the Commission in 2000, implementation of these projects started at best in 2001, generally, by tendering the service contracts for supervision of the implementation. Due to regular delays in tendering and contracting, the first actual works contracts were not signed until 2002. Progress on the ground has gained pace since then, which is witnessed by the progress in the payments made by the Commission to the national authorities.

However, in the two acceding countries Bulgaria and Romania, administrative weakness remained the main challenge facing the implementation of ISPA in 2005. Despite that audit missions undertaken by the Commission in 2005 showed some progress with the ISPA Implementing Agencies, the results achieved in key areas of staff, procurement and financial management required continuous monitoring and need to be enhanced further. In several cases, delays in the execution of projects had accumulated to more than two years from the initial plans. On several occasions, the Commission insisted with the national authorities that the contracting authorities and, in the environment sector, the final beneficiaries adopt a proactive approach, take effective ownership of the different stages of the project cycle, and enhance co-ordination between the project stakeholders.

In Croatia, with the first two projects approved only in December 2005, implementation had not yet commenced.

5.2. Financial management and control – incl. EDIS

The principal requirements under ISPA for both the financial management and control, incl. the treatment of irregularities, are close to those applicable to the Cohesion and Structural Funds. They relate to the establishment of internal financial control systems and procedures that can ensure transparent and non-discriminatory procurement procedures, the accuracy of declared expenditure, adequate internal audit capability, sufficient audit trail and appropriate treatment of irregularities.

During 2005, the audit work as regards *Bulgaria and Romania* included 8 audit missions which focussed to a large extent on closely monitoring, on the spot, of the implementation of the action plans and deadlines that were agreed with the national authorities in 2004 and of the progress achieved towards extended decentralisation (EDIS) which, when achieved, enables the waiving of the *ex ante* control of tendering and contracting by the Commission.

For *Romania*, the level of assurance on the systems in place has quite radically advanced compared to 2004. An EDIS request for accreditation of all ISPA implementing agencies was received by the Commission early 2006. Following a final verification audit, the conferral of EDIS for ISPA for all agencies was granted in June 2006.

For *Bulgaria*, as significant efforts were made in 2005 to close the gaps identified in the management and control systems, the EDIS process was eventually put back on track. An EDIS request for accreditation of all ISPA implementing bodies was submitted to the Commission late April 2006 and is presently being assessed by the Commission services. However, two particularly concerns remain: the issue of public procurement and the shortage of qualified and experienced staff. Despite the close supervision of procurement by the EC Delegation, the experience of ISPA in this respect is indeed one that is characterized by frequent complaints, allegations, etc.

A number of project audits were carried also out in these countries, the main findings of which generally reflected the shortcomings identified during the system audits, namely insufficient quality of tendering and contracting dossiers, irregular procedures during the procurement process, need to improve the verification of expenditure declarations, certification of ineligible expenditure, the lack of (adequate) supporting documents, and the incomplete adherence to publicity and information requirements. Also, as mentioned before, a recurring problem is the lack of qualified and experienced personnel, including its high turnover. As this situation is likely to be a major constraint for the effective utilisation of the future Cohesion and Structural Funds as well, close monitoring of progress in this respect will therefore be ensured.

From their side, the Croatian authorities have mobilised efforts in preparing for the introduction of the Decentralised Implementation System (*DIS*) for PHARE and ISPA. This enabled the Commission to confer decentralised management of ISPA assistance in February 2006 (whereby the EC Delegation still performs *ex-ante* controls).

5.3. Risk assessment

Under the system of *ex ante* approval, the audit strategy with respect to the beneficiary countries focuses largely on prevention, ensuring that each country put in place sufficient control procedures regarding project implementation and payments. Successive audit rounds, including at all stages of EDIS, aim at identifying the shortcomings in the set-up of supervisory and control systems, and at verifying whether the recommendations are implemented and the shortcomings resolved.

5.4. European Court of Auditors findings

In its *Annual report concerning the financial year 2004*, the Court's overall opinion on the pre-accession instruments was that supervisory and control systems were basically sound and worked in practice, although risks continue to exist at the level of the implementing organisations. This opinion was confirmed in the framework of a limited review of ISPA activities in 2005, as a result of which the Court recommended that the Commission monitors closely the systems in question.

5.5. Co-financing partners – EIB, EBRD and KfW

Given their expertise in project preparation and implementation, the Commission regularly met these lending institutions and, where possible, organised joint project identification and appraisal missions for projects for which loan financing was sought. In 2005, loans were provided for two projects by the EIB, for 6 projects by the EBRD, and again for two projects by the KfW.

6. CONTRIBUTION TO COMMUNITY POLICIES

6.1. Public procurement

The fulfilment of legal requirements for sound, fair and transparent public procurement as enshrined in the PRAG has proved to be a major challenge for the acceding beneficiary countries. This results from the fact that the qualifications of staff in these countries are not always up to level of skills required to manage complex infrastructure projects, in particular, as far as tendering and contracting are concerned. Because of the difficulties encountered in this area, the Commission has put many efforts in developing technical assistance activities which focused on strengthening recipients' procurement skills, systems and procedures. Among others, it continued to organise various seminars and training sessions, including the dissemination of manuals and practical guides.

6.2. Environment policy

By providing direct assistance to priority projects for environment, ISPA accelerates the implementation of environmental policy and the compliance with EU standards in the beneficiary countries. In particular, administrative capacity has been strengthened in regard to environmental investment planning and prioritization, and steady progress has also been made in proper implementation of the EIA directive, including aspects related to public consultation. However, problems in relation to the difficulties of environmental authorities in obtaining adequate funding and staffing as well as the lack of co-ordination between policy fields and of strategic planning need to be addressed further by these countries.

6.3. Transport policy

The transport networks in the beneficiary countries, in the case of Bulgaria and Romania, agreed in accordance with TINA (*Transport Infrastructure Needs Assessment*), were constructed around the framework of pan-European corridors. These networks are used as the planning basis for the national transport strategies for ISPA purposes, i.e. concern the construction or rehabilitation of a section, nodal point or access relating to the networks. Six of the fore-mentioned corridors run across the territory of Bulgaria, Croatia and Romania. Under the new Community guidelines for the development of the trans-European transport network (TEN-T), three of the network's priority projects (*motorway axis Igoumenitsa/Patra-Athina-Sofia-Budapest, inland waterway axis Rhine/Meuse-Main-Danube and railway axis Athina-Sofia-Budapest-Wien-Praha-Nürnberg/Dresden*) concern axes which include Bulgaria and Romania, and one which includes Croatia (*railway axis Lyon-Trieste-Divaca/Koper-Divaca-Ljubljana-Budapest-Ukrainian border*).

7. CO-ORDINATION AMONG PRE-ACCESSION INSTRUMENTS

As required by the Coordination Regulation, the Commission ensures close co-ordination between the three pre-accession instruments PHARE, SAPARD and ISPA. The Regulation carefully specifies the fields to which each instrument provides assistance, thereby minimising potential overlaps between the different instruments.

The PHARE Management Committee ensures co-ordination among these three instruments, whereas further co-ordination is implemented through the (PHARE) Joint Monitoring Committee, the inter-services Co-ordination Committee and periodic meetings with the EC Delegations in the beneficiary countries.